Yangarra Resources Ltd.

Condensed Interim Consolidated Financial Statements

June 30, 2012 and 2011

(Unaudited)

Yangarra Resources Ltd.
Condensed Interim Consolidated Statements of Financial Position
As at:
(unaudited)

		June 30, 2012		December 31, 2011
Assets				
Current				
Accounts receivable		**9,495,792**		16,109,194
Prepaid expenses and deposits		**2,913,982**		1,318,702
Assets held for sale *(note 3)*		**463,100**		463,100
Commodity contract *(note 13c iii)*		**4,678,550**		–
Total current assets		**17,551,424**		17,890,996
Non-current				
Property and equipment *(note 3)*		**121,329,749**		119,374,219
Exploration and evaluation assets *(note 4)*		**4,025,828**		4,025,828
Total assets	$	**142,907,001**	$	141,291,043
Liabilities				
Current				
Bank debt *(note 5)*	$	**38,611,081**	$	26,245,533
Accounts payable and accrued liabilities		**7,718,705**		25,673,625
Commodity contract *(note 13c iii)*		–		1,491,875
Flow-through share premium liability		–		1,500,000
Total current liabilities		**46,329,786**		54,911,033
Non-current				
Other long-term debt *(note 12)*		**381,797**		410,000
Decommissioning liability *(note 6)*		**5,146,749**		4,898,222
Deferred tax liability		**9,923,253**		4,444,544
Total liabilities		**61,781,585**		64,663,799
Shareholders' Equity				
Share capital *(note 7)*		**94,717,629**		90,895,319
Warrants *(note 9)*		**241,826**		2,116,564
Contributed surplus		**9,296,770**		8,261,009
Deficit		**(23,130,809)**		(24,645,648)
Total shareholders' equity		**81,125,416**		76,627,244
Total liabilities and equity	$	**142,907,001**	$	141,291,043

Contingency (note 14), Commitments (note 15)

Approved on behalf of the Board of Directors

"James G. Evaskevich" (signed)
James G. Evaskevich

"Gordon A. Bowerman" (signed)
Gordon A. Bowerman

Yangarra Resources Ltd.
Condensed Interim Consolidated Statements of Comprehensive Income (Loss)
For the three and six months ended June 30:
(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	**2012**	2011
Revenue				
Petroleum and natural gas sales	$ **5,265,664**	$ 4,283,356	$ **12,173,076**	$ 7,807,900
Royalty income	**645,002**	35,848	**1,484,179**	140,278
Royalties	**(283,131)**	(56,547)	**(729,948)**	(199,915)
	5,627,535	4,262,657	**12,927,307**	7,748,263
Commodity price risk contracts *(note 13c iii)*				
Commodity contract settlement	**223,840**	244,044	**(201,941)**	273,628
Change in fair value of commodity contracts	**7,989,633**	1,850,977	**6,170,425**	1,004,546
	13,841,008	6,357,638	**18,895,791**	9,026,437
Expenses				
Production	**1,314,640**	702,480	**2,267,313**	1,274,321
Transportation	**156,536**	91,462	**303,908**	161,083
General and administrative	**559,521**	464,764	**929,852**	740,055
Finance	**353,018**	117,501	**633,267**	213,314
Share-based compensation *(note 8)*	**125,124**	–	**356,124**	1,275,455
Depletion, depreciation and impairment *(note 3)*	**4,880,246**	1,507,794	**8,936,738**	2,771,238
	7,389,085	2,884,001	**13,427,202**	6,435,466
Income before tax	**6,451,923**	3,473,637	**5,468,589**	2,590,971
Deferred tax	**3,146,295**	1,807,816	**3,953,750**	3,155,781
Total comprehensive income (loss) for the period attributable to common shareholders	$ **3,305,628**	$ 1,665,821	$ **1,514,839**	$ (564,810)
Net income (loss) per share *(note 10)*				
Basic	$ **0.03**	$ 0.02	$ **0.01**	$ (0.01)
Diluted	$ **0.03**	$ 0.01	$ **0.01**	$ (0.01)
Weighted average number of shares *(note 10)*				
Basic	**121,711,152**	104,762,826	**119,602,943**	95,427,181
Diluted	**121,711,152**	113,332,471	**119,602,943**	103,996,826

Yangarra Resources Ltd.

Condensed Interim Consolidated Statements of Changes in Equity
For the three and six months ended June 30:
(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	**2012**	2011
Share Capital				
Balance, beginning of period	$ **94,707,894**	$ 82,749,296	$ **90,895,319**	$ 65,909,948
Issued	–	8,500,000	–	25,751,725
Share issue costs (net of tax)	–	(529,903)	–	(1,404,101)
Exercise of warrants	**9,735**	9,360	**3,822,310**	147,137
Exercise of options	–	–	–	324,044
Balance, end of period	**94,717,629**	90,728,753	**94,717,629**	90,728,753
Warrants				
Balance, beginning of period	**245,060**	2,170,764	**2,116,564**	2,216,541
Issued	–	–	–	–
Exercised	**(3,234)**	(3,110)	**(1,269,977)**	(48,887)
Expired	–	–	**(604,761)**	–
Balance, end of period	**241,826**	2,167,654	**241,826**	2,167,654
Contributed Surplus				
Balance, beginning of period	**9,096,770**	7,365,309	**8,261,009**	5,740,753
Share-based compensation related to:				
Options granted in current year	**200,000**	–	**431,000**	1,818,600
Exercised options	–	–	–	(194,044)
Expired warrants	–	–	**604,761**	–
Balance, end of period	**9,296,770**	7,365,309	**9,296,770**	7,365,309
Deficit				
Balance, beginning of period	**(26,436,437)**	(28,261,977)	**(24,645,648)**	(26,031,346)
Total comprehensive income (loss)	**3,305,628**	1,665,821	**1,514,839**	(564,810)
Balance, end of period	**(23,130,809)**	(26,596,156)	**(23,130,809)**	(26,596,156)
Total Equity	$ **81,125,416**	$ 73,665,560	$ **81,125,416**	$ 73,665,560

Yangarra Resources Ltd.
Condensed Interim Consolidated Statements of Cash Flows
For the three and six months ended June 30:
(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	**2012**	2011
Operating				
Total comprehensive income (loss) for the period	$ **3,305,628**	$ 1,665,821	$ **1,514,839**	$ (564,810)
Add back non-cash items:				
Change in fair value of commodity contracts	**(7,989,633)**	(1,850,977)	**(6,170,425)**	(1,004,546)
Share-based compensation *(note 8)*	**125,124**	–	**356,124**	1,275,455
Depletion, depreciation and impairment *(note 3)*	**4,880,246**	1,507,794	**8,936,738**	2,771,238
Net financing expenses (including accretion)	**25,343**	21,211	**48,531**	53,798
Deferred tax	**3,146,295**	1,807,816	**3,953,750**	3,155,781
	3,493,003	3,151,665	**8,639,557**	5,686,916
Change in non-cash working capital *(note 11)*	**1,519,959**	(1,008,878)	**(1,689,219)**	(1,887,656)
Net cash flow from operating activities	**5,012,962**	2,142,787	**6,950,338**	3,799,260
Financing				
Issue of equity instruments, net of costs	**6,500**	9,299,713	**2,552,333**	25,607,840
Redemption of preferred shares *(note 7)*	–	–	–	(1,000,000)
Bank debt advance (repayment) *(note 5)*	**3,015,701**	2,127,723	**12,365,548**	(705,838)
Other debt repayment	**(28,203)**	–	**(28,203)**	–
Change in non-cash working capital *(note 11)*	–	45,894	**279,500**	45,894
Net cash flow from financing activities	**2,993,998**	11,473,330	**15,169,178**	23,947,896
Investing				
Expenditures on exploration and evaluation assets and property and equipment	**(3,007,918)**	(7,160,655)	**(10,592,437)**	(25,285,318)
Change in non-cash working capital *(note 11)*	**(4,999,042)**	(6,455,462)	**(11,527,079)**	(2,473,516)
Net cash flow used in investing activities	**(8,006,960)**	(13,616,117)	**(22,119,516)**	(27,758,834)
Change in cash	–	–	–	(11,678)
Cash, beginning of the period	–	–	–	11,678
Cash, end of the period	$ –	$ –	$ –	$ –
Supplemental cash flow information				
Interest paid	$ **327,675**	$ 96,290	$ **584,736**	$ 150,556
Dividends paid	$ –	$ –	$ –	$ 8,960

The accompanying notes are an integral part of these condensed interim consolidated financial statements

1. Basis of preparation, adoption of IFRS and statement of compliance

Yangarra Resources Ltd. (the "Company") is a publicly traded company involved in the production, exploration and development of resource properties in Western Canada. The address of the registered office is 1530, 715 – 5 Avenue SW, Calgary Alberta, T2P 2X6.

These unaudited condensed interim consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Yangarra Resources Corp. ("YRC"), after the elimination of intercompany transactions and balances.

These condensed interim consolidated financial statements, including comparatives, have been prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to the preparation of interim financial statements, including IAS 34 "Interim Financial Reporting", and have been prepared following the same accounting policies as the annual consolidated financial statements for the year ended December 31, 2011. These condensed interim consolidated financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the Company's December 31, 2011 annual consolidated financial statements.

The policies applied in these condensed interim consolidated financial statements are based on IFRS issued and outstanding as of August 17, 2012, the date the Board of Directors approved the statements. Any subsequent changes to IFRS that are given effect to the Company's annual financial statements for the year ended December 31, 2011 could result in restatement of these interim financial statements.

2. Accounting standards issued but not yet applied

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the IASB or International Financial Reporting Interpretations Committee ("IFRIC") that are mandatory for accounting periods beginning after July 1, 2012 or later periods. The standards impacted that are applicable to the Company are as follows:

IFRS 9, 'Financial Instruments' was issued in November 2009 as the first step in its project to replace IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 introduces new requirements for classifying and measuring financial assets that must be applied starting January 1, 2013, with early adoption permitted. The IASB intends to expand IFRS 9 during the intervening period to add new requirements for classifying and measuring financial liabilities, de-recognition of financial instruments, impairment and hedge accounting. The Company is currently assessing the impact of this standard.

IFRS 10, 'Consolidated Financial Statements' was issued in May 2011 and will supersede the consolidation requirements in SIC-12 'Consolidation – Special Purpose Entities' and IAS 27 'Consolidated and Separate Financial Statements' effective for annual periods beginning on or after January 1, 2013, with early application permitted. IFRS 10 builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard also provides additional guidance to assist in the determination of control where this is difficult to assess. The Company is currently assessing the impact of this standard.

IFRS 11, 'Joint Arrangements' was issued in May 2011 and will supersede existing IAS 31, 'Joint Ventures' effective for annual period beginning on or after January 1, 2013, with early application permitted. IFRS 11 provides for the accounting of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form (as is currently the case). The standard also eliminates the option to account for jointly controlled entities using the proportionate consolidation method. The Company is currently assessing the impact of this standard.

2. Accounting standards issued but not yet applied (continued)

IFRS 12, 'Disclosure of Interests in Other Entities' was issued in May 2011 and is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. IFRS 12 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. The Company is currently assessing the impact of this standard.

IFRS 13, 'Fair Value Measurement' was issued in May 2011 and sets out in a single IFRS a framework for measuring fair value. IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This definition of fair value emphasizes that fair value is a market-based measurement, not an entity-specific measurement. In addition, IFRS 13 also requires specific disclosures about fair value measurement. IFRS 13 is effective for annual periods beginning on or after January 1, 2013, with earlier application permitted. The Company is currently assessing the impact of this standard.

IAS 1, 'Presentation of Items of Other Comprehensive Income' – In 2011, the IASB issued amendments to IAS 1 Presentation of Financial Statements to split items of other comprehensive income (OCI) between those that are reclassified to income and those that are not. The standard is required to be adopted for periods beginning on or after July 1, 2012.

IAS 27, 'Separate Financial Statements' – The IASB issued amendments to IAS 27 Separate Financial Statements to coincide with the changes made in IFRS 10, but retains the current guidance for separate financial statements.

IAS 28, 'Investments in Associates and Joint Ventures' – The IASB issued amendments to IAS 28 Investments in Associates and Joint Ventures to coincide with the changes made in IFRS 10 and IFRS 11.

3. Property and equipment

	Oil and Natural Gas Interests	*Well and plant equipment*	*Head Office*	*Total*
Cost or Deemed Cost				
Balance at December 31, 2011	107,553,041	25,192,024	1,127,950	133,873,015
Additions	9,919,479	961,897	10,892	10,892,268
Balance at June 30, 2012	**$ 117,472,520**	**$ 26,153,921**	**$ 1,138,842**	**$ 144,765,283**
Depletion, depreciation and impairment losses				
Balance at December 31, 2011	12,891,345	1,475,500	131,951	14,498,796
Depletion and depreciation	6,907,800	939,900	152,912	8,000,612
Impairment loss	936,126	–	–	936,126
Balance at June 30, 2012	**$ 20,735,271**	**$ 2,415,400**	**$ 284,863**	**$ 23,435,534**
Net book value				
At June 30, 2012	**$ 96,737,249**	**$ 23,738,521**	**$ 853,979**	**$ 121,329,749**
At December 31, 2011	$ 94,661,696	$ 23,716,524	$ 995,999	$ 119,374,219

3. Property and equipment (continued)

The depletion, depreciation and impairment of property and equipment, and any eventual reversal thereof, are recognized in depletion and depreciation in the statement of comprehensive income (loss). At June 30, 2012 all of the Company's properties are pledged as security for the bank loans.

During the six months ended June 30, 2012, the Company capitalized $199,997 (June 30, 2011 – $36,598) related to the decommissioning liability of property and equipment and $99,835 (June 30, 2011 – $nil) of share based compensation. The Company also capitalized $37,500 (June 30, 2011 – $240,690) of general and administrative costs as well as $89,856 (June 30, 2011 - $280,378) of recoveries related to the Company's working interest in operated capital expenditure programs on which overhead has been charged in accordance with standard industry operating agreements.

During the six months ended June 30, 2012 the Company recognized an impairment of $936,126 (June 30, 2011 - $nil) on its Jaslan cash generating unit ("CGU") as the carrying amount exceeded fair value less costs to sell, due to the decrease in natural gas prices. Fair value was determined using the net present value of proved plus probable reserves discounted at 10% in the reserve report.

As at June 30, 2012, property and equipment totaling $463,100 (December 31, 2011 – $463,100) was classified as a current asset held for sale as the Company intends to recover the carrying amount principally through a sale transaction rather than through continuing use in the next twelve months. The current asset classified as held for sale was measured at the lower of its carrying amount and fair value less costs to sell.

4. Exploration and evaluation assets

Cost or Deemed Cost	
Balance at December 31, 2011	8,391,115
Additions	–
Balance at June 30, 2012	**$ 8,391,115**
Depletion, depreciation and impairment losses	
Balance at December 31, 2011	4,365,287
Amortization	–
Balance at June 30, 2012	**$ 4,365,287**
Net book value	
At June 30, 2012	**$ 4,025,828**
At December 31, 2011	$ 4,025,828

5. Bank debt

As at June 30, 2012, the $38,611,081 (December 31, 2011 – $26,245,533) reported amount of bank debt was comprised of $33,650,000 (December 31, 2011 – $24,450,000) drawn on the revolving operating demand loan and $4,961,069 (December 31, 2011 – $1,795,533) of bank overdraft. The Company is subject to a financial covenant with respect to working capital, which the Company was in compliance with at June 30, 2012.

The facility is secured by a fixed and floating charge on the assets of the Company and is secured by a general security agreement.

As at June 30, 2012, the maximum amount available under the revolving operating demand loan was $42,000,000 (December 31, 2011 – $40,000,000) at an interest rate of bank prime plus 1.5% per annum, payable monthly.

6. Decommissioning liability

The following table presents the reconciliation of the carrying amount of the obligation associated with the decommissioning of the Company's property and equipment:

	June 30, 2012	*December 31, 2011*
Balance, beginning of period	$ **4,898,222**	$ 3,501,805
Liabilities incurred	**83,615**	652,382
Liabilities settled	–	(117,761)
Effect of change in rates	**116,381**	502,585
Accretion	**48,531**	107,281
Change in assumptions	–	251,929
Balance, end of period	$ **5,146,749**	$ 4,898,222

The following significant assumptions were used to estimate the decommissioning liability:

	June 30, 2012	*December 31, 2011*
Undiscounted cash flows	$ **6,266,813**	$ 6,120,528
Discount rate	**1.46% - 1.74%**	1.51% - 3.35%
Inflation rate	**2%**	2%
Weighted average expected timing of cash flows	**8.5 years**	8.7 years

7. Share capital

a. Authorized

Unlimited number of common shares, without nominal or par value
Unlimited number of preferred shares, without nominal or par value

7. Share capital (continued)

b. Common shares issued

	Number of shares	*Amount*
Balance December 31, 2011	116,607,057	$ 90,895,319
Exercise of warrants (i)	5,104,666	3,822,310
Balance, June 30, 2012	121,711,723	$ 94,717,629

i) The Company issued 5,104,666 common shares on the exercise of warrants at $0.50 per share for cash proceeds of $2,552,333 plus a pro-rata allocation of the warrants' fair value in the amount of $1,269,977.

8. Share-based payments

The Company has an equity settled stock option plan under which the Board of Directors may grant options to directors, officers, other employees and key consultants. The purpose of the plan is to advance the interests of the Company by encouraging these individuals to acquire shares in the Company and thereby remain associated with, and seek to maximize the value of, the Company. Under the plan, the number of shares reserved for issuance pursuant to the exercise of all options under the plan may not exceed 10% of the issued and outstanding common shares on a non-diluted basis at any time. The options expire not more than five years from the date of grant, or earlier if the individual ceases to be associated with the Company, and vest over terms determined at the time of grant.

During the six months ended June 30, 2012, the Company granted options to purchase 1,385,000 common shares, the options vested immediately. The fair value of the options was estimated at $369,200 ($0.27 per option) using the Black-Scholes pricing model.

The following tables summarize information about stock options outstanding as at:

	June 30, 2012		*December 31, 2011*	
	Options	***Weighted – average exercise price***	*Options*	*Weighted – average exercise price*
Opening	**11,353,800**	**$0.65**	7,808,800	$0.67
Granted	**1,385,000**	**0.52**	4,175,000	0.69
Exercised	**–**	**–**	(260,000)	0.50
Forfeited	**(2,000,800)**	**0.71**	(255,000)	0.72
Expired	**(168,000)**	**1.00**	(115,000)	1.83
Closing	**10,570,000**	**$0.63**	11,353,800	$0.65

The following provides a summary of the stock option plan as at June 30, 2012:

Range of exercise price	*Number outstanding*	*Weighted-average remaining contractual life (years)*	*Weighted-average exercise price*	*Number exercisable*
$ 0.25 – $ 0.50	3,595,000	2.86	$ 0.50	3,595,000
$ 0.51 – $ 0.75	5,640,000	3.47	0.66	5,640,000
$ 0.76 – $ 1.00	1,335,000	3.41	0.86	1,335,000
	10,570,000	3.26	$ 0.63	10,570,000

8. Share-based payments (continued)

The Black-Scholes pricing model was used to estimate the fair value of options granted and warrants issued based on the following significant assumptions:

	2012	*2011*
Weighted average fair value per option	**$0.27**	$0.65
Risk-free interest rate	**1.49% to 1.64%**	1.51% to 2.81%
Expected volatility	**62%**	163% to 164%
Expected life	**5 years**	5 years
Forfeiture rate	**0%**	0%

9. Warrants

The following table summarizes information about warrants outstanding as at:

	June 30, 2012			*December 31, 2011*		
	Number of warrants	***Exercise price***	***Fair value ascribed***	*Number of warrants*	*Exercise price*	*Fair value ascribed*
Opening	**8,955,500**	**$0.50**	**$2,116,564**	9,452,000	$0.50	$2,216,541
Exercised	**(5,104,666)**	**(0.50)**	**(1,269,977)**	(496,500)	(0.50)	(99,977)
Expired	**(2,430,834)**	**(0.50)**	**(604,761)**	–	–	–
Closing	**1,420,000**	**$0.50**	**$241,826**	8,955,500	$0.50	$2,116,564

As at June 30, 2012, warrants had a weighted average remaining life of 2.5 years (2011 – 0.9 years).

10. Net income (loss) per common share

Basic earnings per share was calculated as follows:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	**2012**	2011
Net income (loss) for the period	$ **3,305,628**	$ 1,665,821	$ **1,514,839**	$ (564,810)
Weighted average number of shares (basic)				
Issued common shares at beginning of period	**121,698,723**	103,794,557	**116,607,057**	79,718,127
Stock options exercised	–	–		170,939
Transfer agent correction	–	–		(70)
Warrants exercised	**12,429**	6,731	**2,995,886**	170,202
Effect of shares issued	–	961,538	–	15,367,983
Weighted average number of common shares - basic	**121,711,152**	104,762,826	**119,602,943**	95,427,181

10. Net income (loss) per common share

Diluted earnings per share was calculated as follows:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	**2012**	2011
Weighted average number of shares (diluted)				
Weighted average number of shares (basic)	**121,711,152**	104,762,826	**119,602,943**	95,427,181
Effect of outstanding options	–	1,631,981	–	1,631,981
Effect of outstanding warrants	–	6,937,663	–	6,937,663
Weighted average number of common shares - diluted	**121,711,152**	113,332,470	**119,602,943**	103,996,825

11. Change in non-cash working capital

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	**2012**	2011
Accounts receivable	$ **8,850,793**	$ 236,325	$ **6,613,402**	$ (1,256,573)
Prepaid expenses, assets held for sale and deposits	**(922,142)**	(131,936)	**(1,595,280)**	(147,986)
Accounts payable and accrued liabilities	**(11,407,734)**	(7,522,835)	**(17,954,920)**	(2,910,719)
	$ **(3,479,083)**	$ (7,418,446)	$ **(12,936,798)**	$ (4,315,278)

The changes in non-cash working capital has been allocated to the following activities

Operating	$ **1,519,959**	$ (1,008,878)	$ **(1,689,219)**	$ (1,887,656)
Financing	–	45,894	**279,500**	45,894
Investing	**(4,999,042)**	(6,455,462)	**(11,527,079)**	(2,473,516)
	$ **(3,479,083)**	$ (7,418,446)	$ **(12,936,798)**	$ (4,315,278)

12. Related party disclosure

The condensed interim consolidated financial statements include the financial statements of Yangarra Resources Ltd. and the subsidiary listed below:

Name	*Country of Incorporation*	*% equity interest* 2012	2011
Yangarra Resources Corp.	Canada	100%	100%

Balances between Yangarra Resources Ltd. and its subsidiary have been eliminated on consolidation and are not disclosed in this note. Details of transactions between the Company and other related parties are disclosed below.

During the three and six months ended June 30, 2012 and 2011, the Company was charged or invoiced the following amounts by certain of its officers and directors and by companies controlled by certain of the Company's officers and directors:

12. Related party disclosure (continued)

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	**2012**	2011
Administration and consulting fees	$ **47,457**	$ 46,912	$ **94,505**	$ 190,775
Production and capital expenditures	**16,375**	103,684	**52,341**	95,285
	$ **63,832**	$ 150,596	$ **146,846**	$ 286,060

Included in accounts payable and accrued liabilities at June 30, 2012 is $nil (2011 – $117,020) relating to the above transactions. These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

The $381,797 in other long-term debt is a mortgage held in the name of an officer of the Company. The property the mortgage is against is owned by the Company through a trust agreement and is used as a field office. All mortgage payments are made by the Company.

Compensation of key management personal:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	**2012**	2011
Compensation	$ **270,000**	$ 134,000	$ **515,000**	$ 268,000
Share-based payments	**59,790**	–	**290,790**	867,653
	$ **329,790**	$ 134,000	$ **805,790**	$ 1,135,653

13. Financial instruments and financial risk management

The Company's financial instruments include accounts receivable, bank debt, accounts payable and accrued liabilities, other long term debt and commodity contracts. The carrying values of accounts receivable, accounts payable and accrued liabilities and bank debt approximate their fair values due to their relatively short periods to maturity.

The Company is required to classify fair value measurements using a hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy is as follows:

- Level 1 - quoted prices in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 - inputs for the asset or liability that are not based on observable market data.

The fair value of bank debt is measured at level 1. The fair value of commodity contracts is measured at level 2.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to market conditions and the Company's activities. The Company has exposure to credit risk, liquidity risk and market risk as a result of its use of financial instruments. This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing these risks. Further quantitative disclosures are included throughout these financial statements. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board has implemented and monitors compliance with the risk management policies as set out herein:

13. Financial instruments and financial risk management (continued)

a. Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. A substantial portion of the Company's accounts receivable are with natural gas and liquids marketers and joint venture partners in the oil and gas industry and are subject to normal industry credit risks.

Purchasers of the Company's natural gas and liquids are subject to credit review to minimize the risk of non-payment. As at June 30, 2012, the maximum credit exposure is the carrying amount of the accounts receivable and accruals of $9,495,792 (2011 – $16,109,194). As at June 30, 2012, the Company's receivables consisted of $8,276,512 from joint venture partners and other trade receivables and $1,219,280 of revenue receivable from petroleum and natural gas marketers.

Receivables from petroleum and natural gas marketers are typically collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. The Company historically has not experienced any significant collection issues with its petroleum and natural gas marketers. To mitigate the risk associated with of dealing with a smaller marketer the Company has entered into an arrangement with Computershare to allow them to retain ownership of the product. All of the revenue accruals and receivables from petroleum and natural gas marketers were received in July and August 2012.

Joint venture receivables are typically collected within one to three months of the joint venture bill being issued to the partner. The Company mitigates the risk from joint venture receivables by obtaining partner approval of capital expenditures prior to starting a project. However, the receivables are from participants in the petroleum and natural gas sector, and collection is dependent on typical industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. Further risk exists with joint venture partners as disagreements occasionally arise which increases the potential for non-collection. For properties that are operated by the Company, production can be withheld from joint venture partners who are in default of amounts owing. In addition, the Company often has offsetting amounts payable to joint venture partners from which it can net receivable balances.

The Company did not provide for any doubtful accounts nor was it required to write-off any receivables during the six months ended June 30, 2012. The Company would only choose to write-off a receivable balance after all reasonable avenues of collection had been exhausted.

As at June 30, 2012, the Company considers its receivables to be aged as follows:

Not past due	$	4,448,982
Past due by less than 90 days		1,139,489
Past due by more than 90 days		3,907,321
	$	9,495,792

b. Liquidity risk

Liquidity risk is the risk that the Company will incur difficulties meeting its financial obligations as they are due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions without incurring unacceptable losses or risking harm to the Company's reputation. The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as considered necessary. The Company uses authorizations for expenditures on both operated and non-operated projects to further manage capital expenditures.

13. Financial instruments and financial risk management (continued)

To facilitate the capital expenditure program, the Company has a credit facility agreement, as disclosed in note 5, which is regularly reviewed by the lender. The Company monitors its total debt position monthly. The Company also attempts to match its payment cycle with collection of petroleum and natural gas revenues on the 25th of each month. The Company anticipates it will have adequate liquidity to fund its financial liabilities through its future cash flows. The Company's financial liabilities are comprised of accounts payable and accrued liabilities, bank debt and the credit facility, which have expected maturities of less than one year resulting in their current classification on the statement of financial position.

c. Market risk

Market risk consists of interest rate risk, currency risk and commodity price risk. The objective of market risk management is to manage and control market risk exposures within acceptable limits, while maximizing returns. The Company may use both financial derivatives and physical delivery sales contracts to manage market risks. All such transactions are conducted in accordance with a risk management policy as set out herein:

i. Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate fluctuations on its bank debt which bears interest at a floating rate. For the six months ended June 30, 2012, if interest rates had been 1% lower with all other variables held constant, earnings for the period would have been $76,555 (2011 - $23,585) higher, due to lower interest expense. An equal and opposite impact would have occurred had interest rates been higher by the same amount. The Company had no interest rate swap or financial contracts in place at June 30, 2012.

ii. Currency risk

Foreign currency exchange rate risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in foreign exchange rates. All of the Company's petroleum and natural gas sales are denominated in Canadian dollars, however, the underlying market prices in Canada for petroleum and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar. The Company had no outstanding forward exchange rate contracts in place at June 30, 2012.

iii. Commodity price risk

Commodity price risk is the risk that the fair value or future cash flows will fluctuate as a result of changes in commodity prices. Commodity prices for petroleum and natural gas are impacted by world economic events that dictate the levels of supply and demand as well as the relationship between the Canadian and United States dollar, as outlined above.

As at June 30, 2012, the Company was committed to the following commodity price risk contracts for the sale of oil:

2012 Hedges:

- 100 bbl/d from January 1 to December 31, 2012 at a fixed price of $99.00 CAD/bbl;
- 200 bbl/d from January 1 to December 31, 2012 at a fixed price of $97.00 CAD/bbl;
- 100 bbl/d from January 1 to December 31, 2012 at a fixed price of $93.25 CAD/bbl; and
- 100 bbl/d from January 1 to December 31, 2012 at a fixed price of $100.00 CAD/bbl.

13. Financial instruments and financial risk management (continued)

2013 Hedges:

- 200 bbl/d from January 1 to December 31, 2013 at a fixed price of $98.00 CAD/bbl;
- 100 bbl/d from January 1 to December 31, 2013 at a fixed price of $97.50 CAD/bbl;
- 200 bbl/d from January 1 to December 31, 2013 at a fixed price of $98.30 USD/bbl;
- 100 bbl/d from January 1 to December 31, 2013 at a fixed price of $104.80 CAD/bbl and;
- Sold calls on 200 bbl/d d from January 1 to December 31, 2013 at $110 US/bbl

2014 Hedges:

- 100 bbl/d from January 1 to December 31, 2014 at a fixed price of $98.30 CAD/bbl;
- 100 bbl/d from January 1 to December 31, 2014 at a fixed price of $100.00 CAD/bbl; and
- 100 bbl/d from January 1 to December 31, 2014 at a fixed price of $101.05 CAD/bbl.

As at June 30, 2012, the Company was committed to the following commodity price risk contracts on the AECO basis:

- 1,000 GJ/d at $5.25/ for April 2012 – October 2012; and
- 1,000 GJ/d at $2.22/GJ for July 2012 – October 2012

The following table summarizes the fair value as at June 30, 2012 and December 31, 2011, and the change in fair value for the six months ended June 30, 2012 and year ended December 31, 2011:

	Six Months Ended June 30, 2012	Year Ended December 31, 2011
Commodity contract asset (liability), beginning of period	**$ (1,491,875)**	$ -
Unrealized change in fair value	**6,170,425**	(1,491,875)
Commodity contract, end of period	**$ 4,678,550**	$ (1,491,875)

The following table summarizes the sensitivity of the fair value of the Company's derivative positions as at June 30, 2012 to fluctuations in commodity prices, with all other variables held constant. When assessing the potential impact of these commodity price changes, the Company believes 10 percent volatility is a reasonable measure. Fluctuations in commodity prices potentially could have resulted in unrealized gains (losses) impacting income before tax as follows:

	Impact on Income Before Tax	
	Increase 10%	Decrease 10%
Crude oil	**$ (4,037,625)**	$ 4,097,462
Natural Gas	**$ (43,050)**	$ 43,050

14. Contingency

In December 2009, the Company terminated the Standstill Agreement that it had with an industry partner regarding a joint producing property and served that industry partner with a Statement of Claim issued from The Court of Queen's Bench of Alberta, by which the Company claims breach of the agreements between the parties, gross negligence and default of operator. The Company seeks judgment for specified and such further damages to be determined by the Court, as well as appointment as operator. The Company increased the statement of claim based on the information provided by the defendant and expects the matter to go to trial during 2012. The potential outcome of the lawsuit and claims are undetermined, however, they may be material. As the likely outcome of this litigation cannot be determined at this time, no provision has been made in these consolidated financial statements.

In the normal conduct of operations, there are other pending claims by and against the Company. Litigation is subject to many uncertainties, and the outcome of individual matters is not predictable with assurance. In the opinion of management, based on the advice and information provided by its legal counsel, the final determination of these other litigations will not materially affect the Company's financial position or results of operations. As at June 30, 2012, $650,000 is included in accruals related to these disputes.

15. Commitments

The Company had until December 31, 2012 to incur $10,000,000 of qualifying flow-through expenditures related to flow-through shares issued in June 2011. The flow-through commitment was fully spent in 2011 and during first quarter of 2012.

The Company has entered into lease agreements for office premises, field equipment and Company vehicles with estimated minimum annual payments as follows:

2012	$	119,719
2013	$	160,095
2014	$	50,400